

**Franchise Tax Board****ANALYSIS OF ORIGINAL BILL**

Author: DeSaulnier Analyst: David Scott Bill Number: SB 201  
Related Bills: See Legislative History Telephone: 845-5806 Introduced Date: February 8, 2011  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Corporate Flexibility Act Of 2011/Flexible Purpose Corporation/Corporate Mergers

**SUMMARY**

This bill would create a new type of corporate entity called a “flexible purpose corporation.”

This analysis only addresses the provisions of the bill that would require the department to issue a certificate of satisfaction (tax clearance) upon certain organizational changes between entities.

**RECOMMENDATION AND SUPPORTING ARGUMENTS**

No position.

**Summary of Suggested Amendments**

Amendments have been provided to eliminate obsolete references to the prior (repealed) tax clearance process.

**PURPOSE OF THE BILL**

According to the author, the purpose of this bill is to encourage and permit corporations to be formed or converted from other forms to pursue one or more purposes in addition to creating economic value for shareholders.

**EFFECTIVE/OPERATIVE DATE**

This bill would be effective and operative on January 1, 2012.

**ANALYSIS****FEDERAL/STATE LAW**

In general, a corporation is created under state law, whether pursuant to the California Corporations Code or the laws of another state. In some circumstances, corporations are created under federal law (i.e., Fannie Mae). Current federal and California laws have no corporation types called a “flexible purpose corporation.”

Board Position:

\_\_\_\_\_ S \_\_\_\_\_ NA \_\_\_\_\_ X NP  
\_\_\_\_\_ SA \_\_\_\_\_ O \_\_\_\_\_ NAR  
\_\_\_\_\_ N \_\_\_\_\_ OUA

Executive Officer

Date

Selvi Stanislaus

04/29/11

Under federal law, a corporation is generally taxed based on its taxable income, computed by subtracting deductions from gross income, and taxed at rates that vary from 15 percent to 35 percent.<sup>1</sup>

Under state law, a corporation doing business or receiving income from sources within the state and not expressly exempted from taxation by the provisions of the California Constitution or by the Corporation Tax Law (CTL) is generally subject either to the California franchise or to the income tax at a rate of 8.84 percent.<sup>2</sup>

See “Background” and “Other States” sections for discussions of other forms available (For-Benefit Corporation and L3C) in other states, but not currently available in California.

## BACKGROUND

Some business owners are looking to allow a business entity to remain a corporation while preserving their charitable, environmental, and social business goals, which conflict with the traditional corporate goal of enhancing economic value for shareholders. The story of Ben and Jerry’s Ice Cream is an example of why a new entity form is sought.

“Ben Cohen and Jerry Greenfield founded the company in 1978 with a mission to create top-quality ice cream and give back to the community. They donated 7.5 percent of pretax profits to charity and partnered with nonprofits to open shops in inner-city neighborhoods to employ low-income residents. The company’s feel-good image attracted the interest of multinational corporations. In 2000, Unilever made a buyout offer to the company’s shareholders. Even though Ben and Jerry did not want to sell out, they had little choice. The board could not risk accepting a lower competing offer without exposing itself to litigation from shareholders asserting their right to the highest possible return at the expense of all other considerations – a right upheld by many courts.

Since the takeover, the donations and inner-city shops have gone by the wayside.”<sup>3</sup>

Three new corporate structures have emerged as potential options for new corporate forms. The California Working Group for New Corporate Forms<sup>4</sup> (The Working Group) was formed in 2008 to create a new corporate form that would meet the goal of greater flexibility for corporations. The form created by The Working Group is the Flexible Purpose Corporation that is the subject of this bill. This proposed form of for-profit corporation encourages and permits companies to pursue one or more special purposes in addition to enhancing investor value. The special purpose would be equal to enhancing investor value. This form has been proposed in California only.

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<sup>1</sup> Internal Revenue Code section 11.

<sup>2</sup> Revenue and Taxation Code sections 23151 and 23501.

<sup>3</sup> Kassan, *Protecting your Mission: Legal tools to keep your Company on the Righteous Path* (February 24, 2010) East Bay Express <<http://www.eastbayexpress.com/ebx/protecting-your-mission>>

<sup>4</sup> The self-appointed Working Group consists of a diverse collection of individual corporate lawyers in California – from academia, non-profit firms, organizations fostering social entrepreneurship and large and small corporate law firms. The group is co-chaired by W. Derrick Britt, Partner, Doty, Barlow, Britt, and Thomas, LLP; R. Todd Johnson, Partner, Jones Day; and Susan MacCormac, Partner, Morrison Foerster.

Another alternative that has been proposed in ten states, and adopted in five (not California), is the L3C. The L3C would be a statutory type of LLC that permits the LLC to be organized both for income and wealth accumulation and for socially beneficial purposes. This form would be utilized by a for-profit company with a charitable purpose wishing to attract Program Related Investments by foundations. The charitable purpose of the company would be the primary purpose with making a profit the secondary purpose.

The third alternative form would be the “for-benefit” corporation (B-Corp). This corporate form is the subject of AB 361, currently in the Legislature (See Legislative History). The B-Corp would have as its primary purpose a special purpose that is charitable, social, or environmental in nature. The B-Corp must annually report on the progress of its special purpose and would be subject to audit of its progress.

### THIS BILL

This bill would create, under the California Corporations Code, a new type of corporation called a “flexible purpose corporation” that would be subject to the franchise or income tax under CTL. In addition, this bill would provide the following:

- If the surviving party of a corporate merger is a domestic corporation or a foreign corporation or if a flexible purpose corporation, public benefit corporation, mutual benefit corporation, religious corporation, or corporation organized under the Consumer Cooperative Corporation Law is a party to the merger, the surviving party would be required to file a copy of the agreement of merger with the Secretary of State. The agreement of merger could not be filed until the Franchise Tax Board (FTB) issues a certificate of satisfaction certifying all taxes imposed by that law have been paid or secured.
- If the surviving party of a merger is a non-corporate business entity, and no public benefit corporation, mutual benefit corporation, religious corporation, or corporation organized under the Consumer Cooperative Corporation Law is a party to the merger, the parties to the merger would file a certificate of merger with the Secretary of State. The certificate of merger cannot be filed until the FTB issues a certificate of satisfaction certifying all taxes imposed under CTL have been paid or secured.
- A certificate of satisfaction of the FTB for each disappearing party to the merger would be filed when required under the provisions of this bill or when required by--now repealed--Section 23334 of the Revenue and Taxation Code.
- If a corporation is converting into a flexible purpose corporation, a statement of conversion would be required to be filed with the Secretary of State. The statement or certificate of conversion could not be filed until the FTB issues a certificate of satisfaction certifying all taxes imposed under CTL have been paid or secured. If the converted entity is a flexible purpose corporation, domestic partnership, domestic limited partnership, or domestic limited liability company, the Secretary of State would file the statement or certificate of conversion without the certificate of satisfaction of the FTB and notify the FTB of the conversion.

## IMPLEMENTATION CONSIDERATIONS

This bill would create a certificate of satisfaction process (similar to the repealed tax clearance process) at the FTB for certain mergers involving a Flexible Purpose Corporation. The California Corporations Code provides that the rights of creditors of each of the corporations involved are preserved unimpaired in a statutory merger. The Corporations Code also provides that the surviving corporation assumes the liability of any disappearing corporation or other business entity that was taxed under the PITL or CTL. Since the liabilities of the disappearing corporation are assumed by the surviving corporation in a statutory merger, the certificate of satisfaction process is unnecessary in a statutory merger. The author may want to consider amending the bill to remove the provisions that require a certificate of satisfaction from the FTB.

## TECHNICAL CONSIDERATIONS

Amendments have been provided to eliminate obsolete references to the prior (repealed) tax clearance process.

## **LEGISLATIVE HISTORY**

AB 361 (Huffman, 2011/2012) would create a new type of corporate entity called a “benefit corporation.” The bill is currently in the Assembly Judiciary Committee.

SB 1463 (DeSaulnier, 2009/10), an identical bill, would have created a new type of corporate entity called a “flexible purpose corporation.” No hearing was held for the bill.

AB 2944 (Leno, 2007/2008) would have allowed corporate directors to consider other stakeholders, like employees or the community, when making business decisions. AB 2944 was vetoed by Governor Schwarzenegger on September 30, 2008.

AB 2341 (Villines, et. al, Stats. 2006, Ch. 773) provided that the minimum franchise tax or the annual tax would not be assessed for a taxable year unless specific conditions were met. In addition, this bill eliminated the requirement to obtain a tax clearance certificate from the FTB prior to terminating the existence of certain entities.

## **OTHER STATES**

Illinois, Michigan, Utah, Vermont and Wyoming have all adopted L3C statutes. Arkansas, Missouri, North Carolina, Oregon, and Tennessee are considering passage of the L3C statutes.

Maryland, New Jersey, Vermont, and Virginia have adopted B-Corp statutes.

California is the only state considering the Flexible Purpose Corporation.

## FISCAL IMPACT

This bill would require the FTB to issue certifications of satisfaction certifying that all taxes imposed under the CTL have been paid or secured. This would create a new workload for FTB staff. As a result, this bill would impact the department's costs for processing, printing, mailing and storage of the certifications and an increase in taxpayer calls. The additional costs have not been determined at this time, but will be developed as the bill moves through the legislative process.

## ECONOMIC IMPACT

### Revenue Estimate

Estimated Revenue Impact of SB 201 Operative for Taxable Years Beginning On or After January 1, 2012 Assumed Enactment Date before June 30, 2011 (\$ in Millions)		
2011/12	2012/13	2013/14
Gain/loss less than \$250,000	Gain/loss less than \$250,000	Gain/loss less than \$250,000

## SUPPORT/OPPOSITION

Support: California Working Group for New Corporate Forms (Sponsor).

Opposition: None received.

## ARGUMENTS

Pro: This bill would make a charitable and environmental issue equal to enhancing investor value as a valid purpose of the corporation.

Con: Reinstatement of the tax clearance process would increase the number of entities that do not complete the dissolution or cancelation process and walk away without paying the accrued taxes.

## LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO SB 201

AMENDMENT 1

On page 9, line 9, strikeout "The agreement of"

AMENDMENT 2

On page 9, strikeout lines 10 through 14, inclusive.

AMENDMENT 3

On page 9, line 15, strikeout "secured."

AMENDMENT 4

On page 11, line 14, strikeout "The"

AMENDMENT 5

On page 11, strikeout lines 15 through 19, inclusive.

AMENDMENT 6

On page 11, line 20, strikeout "have been paid or secured."

#### AMENDMENT 7

On page 14, strikeout lines 33 through 36, inclusive.

#### AMENDMENT 8

On page 18, line 16, strikeout “No statement or certificate” and insert:

The Secretary of State shall notify the

#### AMENDMENT 9

On page 18, strikeout lines 17 through 27, inclusive.